

2 J. CW


Economic Growth

Long-Run Aggregate Supply and the Production Possibilities Curve

The long-run aggregate supply (LRAS) curve is vertical at the full-employment level of output. This means that LRAS doesn't change as the price level changes. The location of the LRAS depends on the productive capacity of the economy. Developing more/better resources or improving technology will shift the LRAS curve outward.

The LRAS curve represents a point on an economy's production possibilities curve (PPC). Remember that the PPC represents the maximum output that can be produced given scarce resources. The economy grows if the PPC shifts outward because of more/better resources or technological advances. For the same reason, the LRAS curve shifts outward with more/better resources or if there are technological advances.

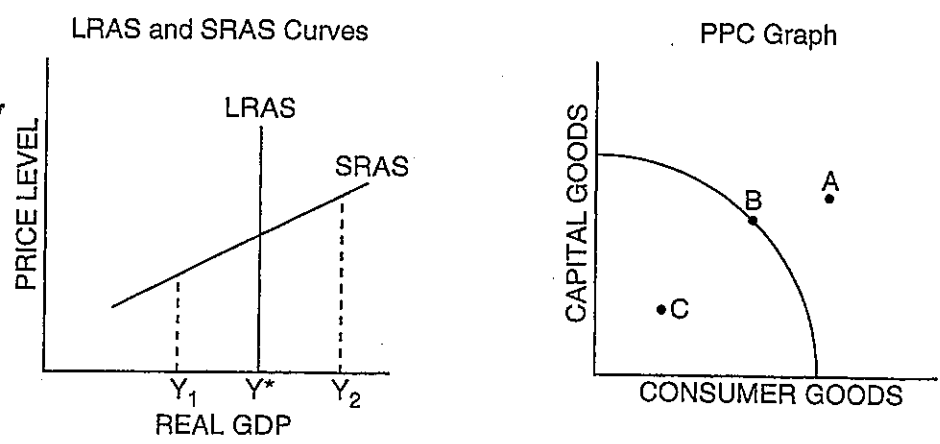
Aggregate output in the economy can actually be greater than LRAS in the short run. This means that resources are being used more intensively. For example, workers can work double hours in the short run. However, they can't continue to work that number of hours in the long run. Eventually, the equilibrium level of output will always return to the full-employment level. Aggregate output can only increase in the long run if the LRAS has increased.

 **Student Alert:** Make sure you don't confuse real gross domestic product (GDP) changes in the short run due to business cycles with long-run economic growth!

Use the graphs in Figure 6-1.1 to answer the questions that follow.



Figure 6-1.1
Aggregate Supply and Production Possibilities Curves



- Economic growth is measured by changes in real gross domestic product or by changes in real GDP per capita.
- Long-run economic growth can be illustrated using a production possibilities curve or a long-run aggregate supply curve. It is shown graphically as a rightward shift of a nation's long-run aggregate supply curve or a rightward shift of its production possibilities curve.
- Long-run economic growth is concerned with increasing an economy's total productive capacity at full employment, also known as its natural rate of output. This output is represented by a vertical long-run aggregate supply curve.
- The rate of economic growth depends largely on increasing productivity. Productivity is affected by a variety of factors including investment in physical capital, increases in human capital, and technological progress.
- Governments can promote economic growth by promoting productivity growth, including:
 - ❑ Investing in physical capital (e.g., providing *infrastructure*—roads, bridges, power lines, information networks)
 - ❑ Providing for the development of human capital (e.g., education and training)
 - ❑ Facilitating technological progress (e.g., research and development)
 - ❑ Providing political stability, enforcing property rights, and providing the optimal amount of government intervention.